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July 27, 1993

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OFFICE OF THE SECRETARY

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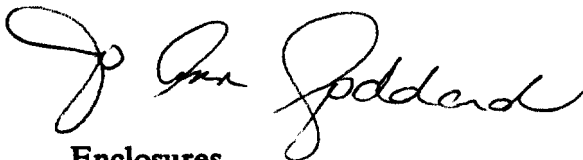
Dear Mr. Caton:

Re: *CC Docket No. 93-193 - 1993 Annual Access Tariff Filings; GSF Order Compliance Filings; Bell Operating Companies' Tariff for the 800 Service Management System and 800 Data Base Access Tariffs*

On behalf of Pacific Bell and Nevada Bell, please find enclosed an original and six copies of their "Direct Case" in the above proceeding.

Please stamp and return the provided copy to confirm your receipt. Please contact me should you have any questions or require additional information concerning this matter.

Sincerely,



Enclosures

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Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554

In the Matter of

1993 Annual Access Tariff Filings

GSF Order Compliance Filings

Bell Operating Companies'

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) CC Docket No. 93-193  
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## SUMMARY

The Pacific Companies' 1993 annual access tariffs should be allowed to remain in effect without being changed. First, carriers should be allowed to recover costs caused by SFAS 106 to the extent they are not reflected in the GNP-PI. The Commission's own requirement to change from cash to accrual accounting for OPEBs triggered the cost increase.

Second, price cap LECs should not be required to "add back" the effect of sharing or low-end adjustments. Mandatory add-back dampens carriers' incentives to be efficient. It is not dispositive that under rate of return regulation, refunds were added back to earnings. Treating sharing like refunds confounds the purposes of rate of return regulation and price caps. The proposal to mandate add-back is also procedurally troubling because it is a substantial change to the price cap rules, not a clarification. Sharing was intended to be "only ... a one-time adjustment to a single year's rates." To fashion substantive rules on the basis of particular tariffs raises obvious issues of fairness and the adequacy of the record on which the new rules are based.

Third, it is permissible to allocate sharing to the common line basket without including end user revenues. The only criterion in the price cap rules for allocating sharing is that it should be done on a "cost-causative basis." Allocating sharing to the common line basket based on carrier common line

revenues is cost-causative because end user common line charges do not reflect any sharing and are not even developed using price cap methods. Once again, the Commission should be wary of changing its rules in the process of adjudicating individual company tariffs.

Fourth, GSF costs have been properly reallocated, as demonstrated in our GSF tariff filings.

Fifth, LIDB service has been properly included in the traffic sensitive basket. The Pacific Companies' tariffs are lawful and should remain in effect.

Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554

In the Matter of

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exogenous treatment of incremental costs resulting from the

Caribbean movement that is what GNS 100 operating for

cap regulation to the extent they are not already reflected in the GNP-PI.<sup>6</sup> "These are costs that should result in an adjustment to the [price] cap in order to ensure that the price cap formula does not lead to unreasonably high or unreasonably low rates."<sup>7</sup>

In the OPEB Order, the Commission misapplied the standard for recovery of exogenous costs. Exogenous costs are those which are "triggered by administrative, legislative or judicial action beyond the control of the carriers."<sup>8</sup> The increase in costs caused by the adoption of SFAS 106 meet this standard. Carriers had no control over the FASB deliberations that led to SFAS 106, and the Commission's requirement to adopt it was clearly beyond their control. Therefore, the increased costs are exogenous and should be recovered to the extent they are not reflected in the GNP-PI. The OPEB Order indicated, however, that because carriers might have some control over the amount of the postretirement benefits themselves, exogenous recovery of SFAS 106 costs should not be granted, except perhaps for transition obligation amortization costs.

The Commission's reasoning is specious. Even if carriers have some ability to control the amount of postretirement benefits in the future, the Commission's

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<sup>6</sup> See Policy and Rules Concerning Rates for Dominant



requirement to change from cash to accrual accounting triggers a cost increase that is clearly beyond their control. If the standard implied by the OPEB Order were applied across the board, carriers would be allowed to recover virtually none of their exogenous costs, because they can nearly all be "controlled" to some extent. This directly contradicts all principles of ratemaking and common sense. The fact is that carriers have very little latitude to unilaterally reduce OPEB costs that have previously been earned by active and retired employees. OPEBs are subject to collective bargaining. Even if a reduction in OPEBs could be successfully negotiated in the future, it would likely be offset by an increase in other bargained wages and benefits. An employer's ability to control OPEB costs is constrained by significant legal, ethical, and business considerations.

Finally, the carriers provided two studies that clearly demonstrated that SFAS 106 would not materially affect the GNP-PI. The Pacific Companies' requests for exogenous recovery incorporated conservative adjustments to ensure there would be no double recovery of OPEB costs from the GNP-PI component of the price cap formula. We strongly believe we met our burden of proof and the full SFAS 106 accrual should be eligible for exogenous recovery. If the Commission does allow exogenous adjustments for TBO costs, it makes no logical sense to disallow exogenous adjustments for other SFAS-106 costs.

II. PRICE CAP LECs SHOULD NOT BE REQUIRED TO  
"ADD BACK" AMOUNTS FROM PRIOR YEAR SHARING OR  
LOW-END ADJUSTMENTS.

The Commission has initiated an investigation pertaining to all LECs that had a 1991 sharing obligation or low-end adjustment.<sup>9</sup> The subject of this investigation is the same as the subject of Docket 93-179. In Docket 93-179, the Commission has proposed "clarifying" the LEC price cap rules to require that price cap LECs "add back" the effect on rates of return of both rate increases and reductions under price caps to share or increase earnings from earlier years.<sup>10</sup> Requiring add-back is unnecessary. LECs should not be required to add back the effects of sharing or low-end adjustments.

It is not dispositive that rate of return carriers are required to follow a practice similar to "add back" in computing their earnings. Unlike rate of return regulation, the Commission intended price cap regulation to "harness the profit-making incentives common to all businesses to produce a set of outcomes that advance the public interest goals of just, reasonable, and nondiscriminatory rates."<sup>11</sup> Carriers are encouraged to reduce their costs or "inputs" by annual productivity adjustments and

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<sup>9</sup> Designation Order, para. 32. Nevada Bell had a sharing amount based on 1991 earnings. Pacific Bell did not.

<sup>10</sup> Price Cap Regulation for Local Exchange Carriers Rate of Return Sharing and Lower Formula Adjustment, CC Docket No. 93-179, Notice of Proposed Rulemaking, FCC 93-325, released July 6, 1993 ("Add-Back NPRM").

<sup>11</sup> LEC Price Cap Order, 5 FCC Rcd 6786.

sharing of earnings that result from any productivity gains that  
exceed the adjustments 12 In contrast, "fulder rate of return

decision to adopt a higher productivity benchmark.<sup>15</sup> Assuming such a risk would be consistent with price cap principles, because it would increase the incentive to become more efficient.

We believe the best way to address this issue is when the Commission reviews LEC price cap regulation. Add-back is not a requirement of the price cap rules as they now stand. Mandatory add-back is not even a "clarification" of the price cap rules. The effect of add-back would be similar to the effect of the permanent automatic stabilizer that the Commission originally proposed but declined to adopt because "based upon a single year's earnings, [it] created perverse incentives."<sup>16</sup> The Commission said that sharing (unlike the automatic stabilizer) would operate "only as a one-time adjustment to a single year's rates, so a LEC would not risk affecting future earnings."<sup>17</sup> Add-back makes sharing into a continuing adjustment.

If it required add-back the Commission would be substantively changing the price cap rules in the guise of a "clarification."<sup>18</sup> It would also undeniably change the balance

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<sup>15</sup> Under price cap rules, carriers are given the opportunity to retain more earnings if they adopt a higher productivity benchmark (reduce rates by an additional one percent). Electing not to add back would give the same "greater risk, greater reward" incentive: the carrier could potentially retain more earnings but would surrender some ability to increase rates if it underearned, or vice versa.

<sup>16</sup> LEC Price Cap Order, 5 FCC Rcd at 6803.

<sup>17</sup> Id.

<sup>18</sup> See AT&T v. FCC, 974 F.2d 1351 (D.C. Cir. 1992), in which the D.C. Circuit reversed a "clarification" by the Commission that substantively changed the AT&T price cap rules.

of risks and benefits that was struck when the price cap rules were adopted. This is not a change that should be attempted in the course of adjudicating the reasonableness of individual tariffs. It is within the Commission's discretion to proceed by rulemaking, rulemaking of particular applicability, or adjudication. But to fashion major rules on the basis of particular tariffs raises obvious issues about the fairness of applying a newly announced rule retroactively and the completeness of the record on which the new rule is based.

In AT&T v. FCC, 978 F.2d 727 (D.C. Cir. 1992), for example, the D.C. Circuit overturned a Commission order that impermissibly relied on the Commission's initiation of a rulemaking with prospective effect to dismiss a complaint seeking retroactive relief. In that decision, the court observed that "[a]gencies do have a fundamental choice whether to interpret and apply federal statutes through adjudication or through rulemaking. But they cannot avoid their responsibilities in an adjudication properly before them by looking to a rulemaking, which operates only prospectively." 978 F.2d at 732. This proceeding marks the other side of the coin: the Commission announces that it may apply retroactively in this proceeding a rule it has only proposed in a different proceeding. This may be an even more egregious confusion of the Commission's quasi-legislative and quasi-judicial roles than in AT&T.

III. PRICE CAP LECS MAY ALLOCATE SHARING ON ANY "COST-CAUSATIVE BASIS." SHARING MAY BE ALLOCATED TO THE COMMON LINE BASKET BASED ON CARRIER COMMON LINE REVENUES.

According to the Commission, "[i]t is not clear that Bell Atlantic's exclusion of end user revenues from the common line basket for sharing purposes is consistent with the LEC Price Cap Order and the 1992 Annual Access Order."<sup>19</sup> Accordingly the Commission has designated Bell Atlantic's PCI adjustments for investigation.<sup>20</sup>

The Commission's price cap rules and its decisions do not specify in detail how sharing is to be allocated. Indeed, the Commission has expressly declined to "specify a particular method of reflecting 'cost-causation.'"<sup>21</sup> The sole criterion is that sharing shall be allocated on a "cost-causative basis."<sup>22</sup> In its order on the 1992 annual access tariffs, the Commission did sanction one particular cost-causative allocation method, observing that "basket revenue can be used as a proxy for basket costs."<sup>23</sup> But it did not rule out all other methods and it properly avoided revising or adding to the price cap rules in the course of deciding the justness and reasonableness of

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<sup>19</sup> Designation Order, para. 42.

<sup>20</sup> Pacific Bell, but not Nevada Bell, also allocated sharing to the common line basket based on carrier common line revenues.

<sup>21</sup> LEC Price Cap Order on Reconsideration, para. 113.

<sup>22</sup> 47 CFR {61.45(d)(4)}.

<sup>23</sup> 1992 Annual Access Tariff Filings, 7 FCC Rcd 4731, 4732 (n. 4) (Com. Car. Bur. 1992) (emphasis added).

specific tariffs. Similarly, in the Common Carrier Bureau's 1993 Tariff Review Plan Order, the Bureau directed carriers to file "their computations of the sharing or low end adjustment amount and of the method used to allocate the amount among the baskets."<sup>24</sup>

It violates no Commission rule or policy to allocate sharing to the common line basket based on carrier common line revenues. Since end user common line charges are not even developed using price cap methods, but are developed from "bottoms up" forecasted cost and methods, sharing will never be reflected in these rates. It is therefore cost-causative to use carrier common line revenues as a proxy for common line costs.

If the Commission changed its rules or adopted a new policy mandating that sharing be allocated to carriers based on end user revenues, it would immediately reduce Pacific Bell's common line revenues even though common line costs have not changed. This proceeding lacks a record adequate to support such rulemaking. In the past the Commission has taken action affecting revenue flows between baskets only after a careful consideration of all relevant economic and public policy matters, as when it provided in Docket 92-222 for reallocating GSF costs or in the price cap docket itself when it mandated a "50% growth factor" for development of carrier common line charges<sup>25</sup> (which

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<sup>24</sup> Commission Requirements for Cost Support Material To Be Filed with 1993 Annual Access Tariffs, Order, DA 93-192, released February 18, 1993, para. 25.

<sup>25</sup> 47 CFR {61.45(c)}.

results in significant annual reductions in those charges). For reasons we have stated above, it would be unwise to make piecemeal changes or additions to the price cap rules based on investigations of individual company tariffs. The Commission should consider a rule change, if at all, only in its reexamination of the LEC price cap rules next year.

#### IV. GSF COSTS HAVE BEEN PROPERLY REALLOCATED.

The Commission decided to suspend and investigate the tariffs that were filed June 17, 1993, to comply with its GSF Order<sup>26</sup> "because of the limited within which to conduct a necessary review of issues concerning the GSF filings and in an abundance of caution."<sup>27</sup> Petitions to reject or suspend and investigate the June 17 tariffs were due before the Designation Order was released. Nonetheless, no petitions were filed. We are therefore unaware of any issues that have been raised concerning these filings. The investigation should be ended and the tariffs permitted to take effect as filed. For the convenience of the Commission and parties, we are attaching as Exhibits A and B the description and justification papers that were filed with these tariffs on June 17.

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<sup>26</sup> Amendment of the Part 69 Allocation of General Support Facility Costs, CC Docket No. 92-222, FCC 93-238, released May 19, 1993.

<sup>27</sup> Designation Order, para. 104.



V. LIDB SERVICE HAS BEEN PROPERLY INCLUDED IN THE TRAFFIC SENSITIVE BASKET.

As the Commission notes, all LECs but one included LIDB query charges in the local transport service category within the traffic sensitive basket.<sup>28</sup> Nonetheless the Commission suspended and investigated these rates, and designated as an issue what category or categories the LIDB per query charges should be assigned to.<sup>29</sup>

We believe the LIDB per query charges were properly assigned to the transport category. The reason is that LIDB query costs are comprised entirely of costs that were allocable to transport under the Commission's rules.<sup>30</sup> We are concerned, as we stated about the Commission's apparent readiness in this proceeding to amend its price cap rules to require add-back or specify a sharing allocation method, that this is a rule change that would be better off addressed in the pending review of LEC price cap rules than in a decision on individual company tariffs. We note also that the LIDB tariffs are already subject to a pending investigation.<sup>31</sup> This issue should be resolved in

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<sup>28</sup> Designation Order, para. 62. Nevada Bell does not have a tariff for LIDB service.

<sup>29</sup> Designation Order, para. 105.

<sup>30</sup> These costs were assigned under Part 32 to accounts 2212, 2211, and 2232. Part 36 and 69 rules further identify these costs as transport.

<sup>31</sup> See Local Exchange Carrier Line Information Data Base, CC Docket No. 92-24, DA 92-347 (released March 20, 1992).

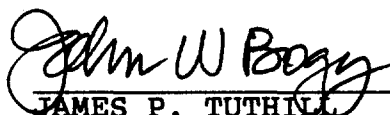
favor of the Pacific Companies before further uncertainty about the lawfulness of these tariffs is created.

VI. CONCLUSION.

For the foregoing reasons, the investigation of the Pacific Companies' 1993 annual access charge filings should be concluded without refunds or directing them to refile any of their tariffs.

Respectfully submitted,

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NEVADA BELL

  
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Date: July 27, 1993

CERTIFICATE OF SERVICE

I, C. A. Peters, hereby certify that copies of the foregoing "DIRECT CASE" of Pacific Bell and Nevada Bell, re CC Dkt. 93-193, were served by hand or by first-class United States mail, postage prepaid, upon the parties appearing on the attached Service List this 27th day of July, 1993.

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**EXHIBIT A**

**PACIFIC BELL**

**DESCRIPTION AND JUSTIFICATION**

**FILED IN COMPLIANCE WITH THE COMMISSION'S  
REPORT AND ORDER IN CC DOCKET NO. 92-222 OF MAY 19, 1993**

**TRANSMITTAL LETTER NO. 1635**

**JUNE 17, 1993**

**PACIFIC BELL**  
**TRANSMITTAL LETTER NO. 1635**

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## I. INTRODUCTION AND SUMMARY

The information which follows supports the rate changes proposed by Pacific Bell to implement the Part 69 rule change ordered in the Commission's Report and Order of May 19, 1993 in CC Docket No. 92-222 regarding the allocation of General Support Facilities costs ("the GSF Order").

The net effect of the GSF Order on Pacific Bell is revenue neutral and consists of a \$96M shift in interstate cost recovery. However, the GSF Order resulted in changes in the price cap indices (PCIs) for the various baskets which result from inclusion of the exogenous cost adjustment for the GSF cost shift.

In general, the PCI changes required Traffic Sensitive and Special Access rates to be reduced to remain within the re-established pricing bands and to produce APIs below the revised PCIs. It was necessary to increase the Carrier Common Line Charge to match the revised PCI and to ensure proper cost recovery.